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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

Nos. 373-385

GEORGE WHITNEY,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and 12 Consolidated Cases.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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COMMISSIONER OF INTERNAL REVENUE,

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the United States:

The petitioners in these 13 consolidated cases pray the issuance of writs of certiorari to the United States Court

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[1] *Henry C. Alexander* v. *Commissioner; Arthur M. Anderson and Alice M. Anderson, Husband and Wife,* v. *Commissioner; I. C. Raymond Atkin and Winnifred Atkin, Husband and Wife,* v. *Commissioner; Henry P. Davison* v. *Commissioner; Charles D. Dickey and Catherine C. Dickey, Husband and Wife,* v. *Commissioner; Thomas S. Lamont* v. *Commissioner; Estate of Thomas W. Lamont, Deceased, Florence C. Lamont, Thomas S. Lamont and J. P. Morgan & Co. Incorporated, Executors,* v. *Commissioner; Russell C. Leffingwell and Lucy H. Leffingwell, Husband and Wife,* v. *Commissioner; William A. Mitchell* v. *Commissioner; Estate of J. P. Morgan, Deceased, Junius S. Morgan, Henry S. Morgan and J. P. Morgan & Co. Incorporated, Executors,* v. *Commissioner; Junius S. Morgan and Louise C. Morgan, Husband and Wife,* v. *Commissioner; Estate of Frances D. Bartow, Deceased, J. P. Morgan & Co. Incorporated, Executor, and Sabina R. Bartow, Wife of said Francis D. Bartow,* v. *Commissioner.*

of Appeals for the Second Circuit to review the judgments and decisions of that Court rendered on August 11, 1948, in so far as such judgments and decisions held that certain losses admittedly sustained on the sale of certain assets by the firm of J. P. Morgan & Co. to a newly incorporated New York trust company are not allowable for income tax purposes under Section 24(b)(1)(B) of the Internal Revenue Code, which judgments and decisions reversed a unanimous decision of the full Tax Court of the United States promulgated on May 14, 1947.

The cases were consolidated for trial in the Tax Court, and were consolidated for hearing and decision in the Court below.

Summary Statement of Matter Involved

The facts are not in dispute. For over 80 years the firm of J. P. Morgan & Co., a New York partnership, was engaged in a general banking business, in New York City under the name of J. P. Morgan & Co. and in Philadelphia under the name of Drexel & Co. In the latter part of 1939 the partners (the 13 petitioners in these consolidated cases) decided, for reasons which have nothing to do with the controversy here involved, to incorporate the New York business as a trust company, and arrangements to that end—which involved also the complete separation of the Philadelphia business—were completed in March, 1940. A trust company was duly organized under the laws of New York, called "J. P. Morgan & Co. Incorporated". On March 29, 1940, in accordance with the requirements of Section 93 of the New York Banking Law, the stock of the trust company was issued for cash, the petitioners acquiring 72.9%, relatives of such petitioners 5.3%, and persons wholly unrelated to the petitioners 21.8% (R. 8a-9a). The firm of J. P. Morgan & Co. did not subscribe for, purchase or at any time own any of the trust company's stock.

Following the issuance of the new trust company's stock for cash and the receipt of the official authorization

certificate to do business, on March 30, 1940 (which was a Saturday), the new trust company under a formal Bill of Sale and Agreement (R. 224a) purchased the assets of the firm of J. P. Morgan & Co. at current market values, assumed the liability obligations of the firm, all as set forth in the Bill of Sale, and paid to the firm $12,265,394.09 in cash (in the form of a check payable to the firm and deposited by the firm in the firm's account with The National City Bank of New York), representing the difference between the agreed value of the assets sold and the amount of the liabilities assumed. The Bill of Sale recited that "Whereas, the Firm * * * now desires to sell to the Bank its banking business * * *" and "the Bank * * * desires to purchase the assets, rights and properties hereby sold to it", and provided that "The Firm and each of the Partners, respectively, hereby sells * * * to the Bank" the firm assets, rights and properties, as detailed by schedule. Following the closing under the Bill of Sale on March 30, 1940, the firm was liquidated and dissolved and its affairs were wound up by settlement with the several partners. On Monday, April 1, the new trust company opened for business and has since been carrying on business.

The assets which were the subject matter of the sale between the firm and the trust company consisted only of firm assets dedicated to the business of the firm, and the Tax Court and the Court of Appeals expressly so found (R. 22a, 259a).

Among the assets sold were the firm's investment securities, some of which showed capital gains on the sale and some of which showed losses. The amounts of the capital gains and losses are not in dispute. The short- and long-term gains taken into account aggregated $1,835,571, and the short- and long-term losses taken into account aggregated $2,829,239 (R. 9a). Under Section 182 of the Internal Revenue Code applicable in 1940 (see Appendix), a partner in computing his net income is required to include in his individual income tax return his distributive share of the

partnership capital gains and is entitled to deduct his distributive share of the partnership capital losses. In auditing the individual returns of the several partners for 1940, the Commissioner taxed the distributive share of the partnership gains but disallowed the losses, and found deficiencies which, with interest, aggregate $1,132,189. The losses were disallowed solely on the ground that the sale giving rise to the losses was a sale "between an individual and a corporation" within the meaning of Section 24(b)(1)(B) of the Internal Revenue Code.

The Tax Court, acting *en banc*, with none of the Judges dissenting, held that Section 24(b) did not apply and allowed the losses (R. 21a-29a). The Court of Appeals reversed and sustained the Commissioner (R. 274a).

Basis of Jurisdiction

The judgments of the Court below were entered on August 11, 1948 (R. 275a-300a). The jurisdiction of this Court is invoked under Sections 1254 and 2101 of the Judicial Code effective September 1, 1948 (28 U. S. C.).

Questions Presented

1. Is a New York partnership formally organized and operating under written articles of partnership with a stated capital and engaged in carrying on an extensive banking business including the receipt of large deposits—a genuine and in no sense a pretended business enterprise—"an individual" within the meaning of Section 24(b)(1)(B) of the Internal Revenue Code?

2. Was it the intention of Congress, under a statute taxing the gains on a sale by "an individual" but disallowing the losses, to reach the partnership form of business?

3. Are the rights of a partner in the firm assets (within the intendment of the tax laws) such that the several partners can be said to own individually the firm assets, or are

the rights of the partners limited to having the firm assets devoted to firm business, and to sharing in any profits which such assets produce and in any surplus upon final winding up?

4. Did the Court of Appeals have power to reverse the unanimous decision of the Tax Court, when such decision had warrant in the record and a reasonable basis in law?

Reasons for Allowing the Writ

1. ***Under the decision of the Court below two important questions of Federal law arise which have not been, but should be, settled by this Court.***

(1). For 15 years the problem of the true status of a partnership for tax purposes has vexed the Bar, the Bench and the Treasury alike. While the factual background varies from case to case, the ultimate question—still unanswered—is invariably the same, regardless of the character of the particular tax controversy: Do the partners own the firm assets individually; or is the partnership to be regarded for tax purposes as a separate business entity, with each partner entitled only to have the firm assets devoted to the firm business, to his share in the earnings and in any surplus on liquidation? Although the latter view has largely prevailed in the courts, the Commissioner has stubbornly adhered to the individual ownership theory. Hence, the extensive litigation that has pursued this question from the outset.

On May 17, 1948, the controversy over this question appeared at last to have come to an end. On that date this Court denied certiorari in the case of *Commissioner* v. *Lehman*, 165 F. (2d) 383 (1948), wherein the Court of Appeals for the Second Circuit (speaking through Judge Learned Hand) overthrew the Commissioner's contentions and held that (at p. 385)—

> "while the firm never became a jural person, capable of being sued and of suing as such, in the administration of its affairs it did become for most purposes an entity;

> and it was upon this traditional structure that Congress fitted the taxation of partnerships * * *."

The settlement of this long-standing controversy was short-lived. Within eight months a different bench within the Second Circuit has now in this case squarely repudiated the *Lehman* decision. Judge Clark now holds that (R. 268a)—

> "Basically, the tax law adopts the common-law concept of the partnership as an aggregate of individuals operating the properties of the partnership enterprise as co-owners."

It is impossible to reconcile the opinion in the *Lehman* case with the view now adopted by Judge Clark. The two decisions are fundamentally and diametrically opposed.

In this state of the decisions, what guiding principle is the Commissioner to follow in partnership cases, and how can taxpayers properly make returns with any assurance of complying with the law? With a large part of the country's business conducted in partnership form, the question here presented arises with a frequency that is as disturbing as it is unavoidable. Virtually every partnership at some point or another must meet it head on. As in the case of a conflict in circuits, authoritative guidance from this Court is imperative, if the existing confusion resulting from these two diametrically opposed decisions is not to be worse confounded.

(2). In overruling the expert opinion of a unanimous Tax Court, the Court of Appeals plainly violated the rule of *Dobson* v. *Commissioner*, 320 U. S. 489 (1943). This decision was predicated upon the language of Section 1141 (c)(1) of the Internal Revenue Code, which, under the caption "Powers", provided—and still provides—that the Courts of Appeals may modify or reverse "if the decision of the Board is not in accordance with law".

Effective September 1, 1948—after the decision of the Court of Appeals in this case was handed down and judgment entered—Congress amended, not Section 1141(c) but Section 1141(a), which relates to the *jurisdiction* of the

reviewing court and not to the *scope* of its review (P. L. 773, 80th Cong., 2d Sess., §36). The amendment reads as follows:

> "The circuit courts of appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, *in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury;* * * *." (Italicized clause added by amendment.)

Accordingly, two questions of primary importance arise: First, does the new legislation apply to a case in which the decision of the Court of Appeals was handed down and judgment entered prior to the effective date of the new law? Second, if the amendment does apply in such a case, to what extent does it affect the *Dobson* rule? In view of the innumerable cases which have been decided on the basis of the *Dobson* rule within the past few years, the importance of deciding these questions at this time can hardly be disputed.

2. *The decision below is believed to be in conflict with the applicable decisions of this Court.*

In holding that "the partnership [is] an association of individuals who are co-owners of its specific property", the Court below disregarded the decisions of this Court in *Case* v. *Beauregard*, 99 U. S. 119 (1879), and *Blodgett* v. *Silberman*, 277 U. S. 1 (1928), wherein this Court expressly held that partners are not the individual owners of the partnership's property. In the *Beauregard* decision, long recognized as a landmark in the law of partnerships, this Court stated (99 U. S. at 124):

> "No doubt the effects of a partnership belong to it so long as it continues in existence, and not to the individuals who compose the firm. The right of each partner extends only to a share of what may remain after payment of the debts of the firm and the settlement of its accounts."

The *Silberman* case applied this principle. In view of the rights and limitations imposed upon a tenancy in partnership this Court, speaking through Chief Justice Taft, concluded that the right of a partner is nothing more than the right "to share in what would remain of the partnership assets after its liabilities were satisfied" (277 U. S. at 11). On this reasoning the Court held that Connecticut could impose an inheritance tax on a Connecticut resident in respect of his partnership interest in a New York partnership which owned, among other things, New York real estate, even though such real estate if owned directly was beyond the power of Connecticut to tax.

3. ***The decision below has construed Section 24(b)(1)(B) in a manner so novel as to call for review by this Court because of the far-reaching consequences of such construction.***

In holding as it did that a partnership is "an individual" within the meaning of Section 24(b)(1)(B), and thus exposed to the harsh rule that gains on a sale are taxed while losses are disallowed, the Court below announced a principle which will seriously prejudice the legitimate freedom of action of business partnerships in changing the form of their business.

For example, a banking business carried on in corporate form may sell its assets to a new bank or trust company having the same stockholders, thus resulting in the retention of control over the assets sold, and yet not run afoul of Section 24(b), since the section concededly does not apply to a sale made by one corporation to another corporation, save in the narrow case where one is a personal holding company. Likewise a banking business in partnership form may sell its assets to another and separate banking partnership composed of the same or somewhat different partners, again resulting in the retention of control over the assets sold, without incurring the penalty of Section 24(b). Yet under the decision below a banking partnership cannot sell its assets to a new banking corporation

in which the partners retain control, without subjecting the partners to this penalty.

A sale between two corporations is quite secure, and a sale between two partnerships is quite secure, even though in both instances there is a retention of control over the assets sold. But a sale by a partnership to a corporation or by a corporation to a partnership exposes the partners or the corporation, as the case may be, to a tax on the gains and a disallowance of the losses. When complete freedom of action is accorded the first two kinds of transaction, it is utterly inconceivable that Congress intended to burden so drastically a sale between a partnership and a corporation, whether occurring in the process of incorporating the business or in the ordinary course of business.

The decision below is as novel as it is far-reaching, and clearly calls for review by this Court.

Prayer

For the foregoing reasons, which are developed in more detail in the accompanying brief, your petitioners pray that writs of certiorari issue out of this Court to the United States Court of Appeals for the Second Circuit, and that the duly certified copy of the transcript of the proceedings below and the printed appendix which accompany this petition shall be treated as though filed in response to the aforesaid writs to the end that these cases may be reviewed and determined by this Court; that the judgments and decisions of the Court of Appeals be reversed; and that your petitioners be granted such other and further relief as may be proper.

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New York, N. Y., October 28, 1948.

BRIEF IN SUPPORT OF PETITION

Opinions Below

The opinion of the Tax Court is reported in 8 T. C. 1019 and appears at R. 6a-31a. The opinion of the Second Circuit Court of Appeals is reported in 169 F. (2d) 562 and appears at R. 257a.

Jurisdiction of this Court

This is set forth at p. 4 in the preceding petition under the heading "Basis of Jurisdiction".

Statement of the Case

This is stated in the petition at pp. 2-4 under the heading "Summary Statement of Matter Involved".

Statutes Involved

The statutes involved are set forth in an appendix attached to this brief.

Specification of Errors to be Urged

The Court of Appeals erred

(1) in holding that the sale of partnership assets by the partnership of J. P. Morgan & Co. to the new trust company was a sale by "an individual" within the meaning of Section 24(b)(1)(B);

(2) in holding that the legislative history of Section 24(b)(1)(B) shows that the word "individual" was intended to include a partnership, when the legislative history indicates quite the contrary;

(3) in applying to a modern partnership under the Uniform Partnership Act the now outmoded theory of the common law that partners own the firm assets individually, as in the case of joint owners who are not partners;

(4) in reversing the unanimous decision of the Tax Court, when that decision had warrant in the record and a reasonable basis in law.

Preliminary Statement

The Court below spoke of the "legal device of the partnership" and its "interposition" to bring about the allowance of tax losses, and made much of what it called "the more spectacular cases" brought out by the investigations of the Senate Committee on Banking and Currency in 1933. The implications are without warrant.

This is not a case of the use of a partnership as a device. The Commissioner made no such implication. The Tax Court did not. The firm of J. P. Morgan & Co. was formed and doing an extensive business many years before the income tax laws were enacted. The reasons for incorporating the business were business reasons and had nothing whatsoever to do with income taxes or their avoidance, and any implications to the contrary have no place whatsoever in this case.

As to the Senate Committee's investigation, the record of the hearings and the accompanying report, as we point out hereafter, show that there was not one single instance cited or discussed which would indicate that the investigating committee was either interested in or considering the disallowance of a loss on a sale by or to a partnership.

ARGUMENT

POINT I

The Court below erred in holding that the partnership of J. P. Morgan & Co. was "an individual" within the meaning of Section 24(b)(1)(B).

There is not a particle of justification in the statute for wrenching the word "individual" out of its usual sense and construing it to include a partnership. Though the term "individual" is not defined in the statute, the distinction between an "individual" and a "partnership" is carefully preserved throughout. See Sections 107, 143, 181, 187, and 211(b), and especially Section 24(b)(2), which makes frequent use of both "individual" and "partnership" but in

such a manner that in not one instance is it possible to substitute "partnership" for "individual", or "individual" for "partnership", without destroying the sense of the passage. Indeed, there is not a single instance in our revenue laws where the word "individual" includes a partnership. If Congress had so intended in Section 24(b)(1)(B), it would have said so.

Perhaps the most explicit—if not compelling—evidence that Congress does not regard a partnership as an individual is contained in Section 503(a)(1), which sets forth the rules for determining the ownership of stock in a personal holding company—rules which are identical with the rules for determining the ownership of stock in Section 24(b)(2)(A). Under the descriptive caption "Stock not owned by individual", appears the following: "Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust * * *." Here is a clear declaration in the statute itself that a partnership is not an individual. This declaration applies with equal force to Section 24(b), for the purpose and the wording of Section 503(a)(1) are identical with the purpose and the wording of Section 24(b)(2)(A).

As the petition points out (p. 8, *supra*), it is quite unreasonable to ascribe to Congress an intention to classify a partnership as an "individual" under Section 24(b) and so impose a penalty on a sale or exchange between a partnership and a corporation, when concededly a sale between two corporations or between two partnerships, regardless of continued control, is outside the statute. Yet, if the construction of Section 24(b) adopted by the Court below stands, there is no escape from this unwarranted discrimination. The non-recognition provisions of the statute afford no relief, or at best inadequate relief. The only applicable section, Section 112(b)(5), requires an "exchange" of securities for property pursuant to a plan, a retention of 80% control in the transferors and a continuance of their

same relative interests in the property transferred. The incorporation of a banking partnership cannot qualify, since under the laws of most states, as in the case of New York, the transferee bank would not be permitted to issue its stock except for cash, thus precluding an "exchange" within the section. In the case of nonbanking partnerships, the section is of limited application, for, even assuming that Section 112(b)(5) would prevail over Section 24(b) in cases falling within both sections, the remaining requirements involving the retention of control and the continuance of the same relative interests would in many instances be impossible to meet.

As a matter of statutory construction, therefore, it would seem crystal clear that "individual" does not include a partnership. Nor is there anything in the legislative history evidencing a different intention.

POINT II

The Court below erred in holding that the legislative history of Section 24(b)(1)(B) shows that the word "individual" was intended to include a partnership, when the legislative history indicates quite the contrary.

The Court below, in assuming that *any* transaction within the general field of the legislation must necessarily be within its terms, and in rejecting any need for fine differentiation (R. 263a-265a), clearly misread both the statute and the legislative history. The statute does not purport to reach all transactions in which there is a "near-identity of economic interests". In *McWilliams* v. *Commissioner*, 331 U. S. 694 (1947), this Court stated (p. 699) that the prohibition of Section 24(b) applies to sales between members of "certain designated groups", adding that the one common characteristic of these groups is that their members "generally have a near-identity of economic interests." Certainly this does not justify the inference, which Judge

Clark indulged in, that the existence of a near-identity of economic interests brings within the designated groups a relationship which otherwise is not within the section. The statute does not reach, for example, sales between two corporations with common ownership, unless one of the corporations is a personal holding company. It does not reach sales between partnerships having partners in common nor between an individual and a partnership of which the individual is a member.[2] On the contrary the statute designates with almost algebraic precision the specific classes of relationships within which losses on sales are disallowed. That this was the deliberate purpose of the Committee on Ways and Means is shown clearly by its Report, 75th Cong., 1st Sess., H. R. Rep. No. 1546, pp. 26, 27, 28. After reciting certain precise relationships falling within and without the section, the Report states (p. 28):

> "It will be observed from the foregoing table that the amendments made by Section 301 (a) and (b) do not reach all possible situations in which, due to family relationships or friendly control, artificial losses might be created for tax purposes."

This being the case, when Congress failed to specify a partnership, it would seem quite evident that the inclusion of a partnership was not intended.

The Court below thought that to hold the present transfer beyond the scope of Section 24(b) "would leave untouched the more spectacular cases which the investigation of the Senate Committee on Banking and Currency had brought to public attention", citing *Commissioner* v. *Lamont,* 156 F. (2d) 800 (C. C. A. 2d, 1946) (R. 263a).

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[2] There is of course a valid reason for excluding from Section 24(b) transactions involving partnerships and corporations. Assets devoted to a business purpose cannot be transferred from one business entity to another for the purpose of establishing tax losses without incurring other serious business and tax consequences.

Neither the Senate Banking Committee investigation nor the *Lamont* case justify any such conclusion. The only *partnership* question which had provoked the interest of the Senate Banking Committee was whether the existing rule permitting a partnership net capital loss to be used as an offset against the individual capital gains of the partners did not result in an unwarranted loss of revenue. Following the investigation, in 1934 the revenue laws were amended, and in the *Lamont* case (involving 1937) Judge Clark held that under the amendment partnership losses could be used to offset partnership gains plus $2,000 and no more, thus recognizing the allowance of the losses but limiting their use within the partnership. In 1938 the law again was changed, and the deduction restored to the partner, so that in 1940, the year we are concerned with, the only partnership question which had provoked the interest of the Senate Banking Committee had ceased to have any significance. Even under the *Lamont* case, the partnership losses were allowed and used within the partnership to offset partnership gains, while we are concerned here with the question whether partnership losses are allowable *at all*—a wholly different question. In drawing upon the Senate Banking Committee hearings to support its interpretation of Section 24(b), the Court below completely misconceived the scope and direction of such hearings. Throughout the Senate Banking Committee hearings, the Senate Banking Committee Report and the Ways and Means Committee hearings on the 1934 amendment underlying the *Lamont* case, and indeed, in the Committee hearings and reports involving Section 24(b), *there is not a single instance cited or discussed which would indicate that Congress was interested in or considering the disallowance of a loss sustained on a sale by or to a partnership.*

The Ways and Means Committee was deliberating upon the amendments underlying the *Lamont* case and upon Section 24(b) on the very same days. In the Committee reports dealing with the *Lamont* amendments we find a clear indication of how Congress looked at a partnership for tax purposes. In discussing the *Lamont* case amend-

ments, Congressman Hill, Chairman of the Subcommittee of the Ways and Means Committee, expressed the view that a partnership in "strict sense is not a legal entity, but it is as a matter of fact a business set-up, separate and apart from each individual partner associated in the partnership."[3] The Committee thereupon returned to the discussion of Section 24(b), and under questioning by Congressman Vinson directed at "transactions in the family" the Treasury indicated its approval of the Subcommittee's proposal.[4] (Id. pp. 113-114.)

It is useless to argue, as the Court below argued, that the decision of the Tax Court leaves "a loophole almost as large as the one it [Congress] was trying to close" (R. 262a) and "would substantially emasculate the legislative prohibition" (R. 269a). It is plain from the Committee reports that Congress intended to exclude from the statutory coverage many relationships where near-identity of economic interests existed. See p. 14, *supra.* As to these cases, the losses would still be disallowed when, in the language of the House Committee Report, "the transaction lacks the elements of good faith or finality, generally characterizing sales and exchanges of property." Indeed the Commissioner has ready at hand the decision of this Court in *Higgins* v. *Smith,* 308 U. S. 473 (1940), wherein a sale by a stockholder to his "controlled corporation" made prior to the enactment of Section 24(b) was disallowed because the sale was not of sufficient substance "finally to determine a loss."

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[3] Hearings before the Committee on Ways and Means, "Revenue Revision, 1934," 73d Cong., 2d Sess., p. 109.

[4] It is highly significant, we suggest, that the Chairman of the Subcommittee of the Ways and Means Committee which drafted the original 1934 text of what is now Section 24(b) as well as the 1934 amendments involved in the *Lamont* case, and who was manager on the part of the House and signed the subcommittee report and the conference report relating to both aspects of this legislation, was the Honorable Sam B. Hill, who is now a member of the Tax Court and concurred in the decision of the Tax Court.

POINT III

The Court below erred in applying to a modern partnership under the Uniform Partnership Act the now outmoded theory of the common law that partners own the assets of the firm individually, as in the case of joint owners who are not partners.

In holding that a partnership was a mere aggregation of individuals owning *as individuals* the partnership's assets, the Court below departed from the decisions of this Court in *Case* v. *Beauregard* and *Blodgett* v. *Silberman* (*supra*, p. 7), and repudiated even its own prior decision in *Commissioner* v. *Lehman* (*supra*, p. 5).[5] This result, it says, is compelled by the provisions of the New York Partnership Law, a plainly erroneous conclusion.

Section 50 of the New York Partnership Law states that the rights of a partner are "(a) his rights in specific partnership property, (b) his interest in the partnership, and (c) his right to participate in the management". But his right in specific partnership property, as Section 51 clearly shows, is exercisable solely "for partnership purposes", is "not assignable except in connection with the assignment of the rights of all the partners in the same property", is "not subject to attachment or execution, except on a claim against the partnership", on death "vests in the surviving partner or partners", and is not "subject to dower, curtesy, or allowances to widows, heirs, or next of kin". The effect of these provisions is to reduce the partner's interest, as

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[5] As early as 1928 the Board of Tax Appeals, following the *Beauregard* and *Silberman* cases, adopted the view that a partnership is to be regarded as a unit separate and distinct from the individual partners, and it consistently has applied this principle in a variety of situations ever since. See, e.g., *Harris* v. *Commissioner*, 11 B. T. A. 871, 874-5 (1928), aff'd 39 F. (2d) 540; *Wilson* v. *Commissioner*, 16 B. T. A. 1280, 1287 (1929); *Humphrey* v. *Commissioner*, 32 B. T. A. 280, 283 (1935); *Ford* v. *Commissioner*, 6 T. C. 499, 501 (1946); *Lehman* v. *Commissioner*, 7 T. C. 1088 (1946).

this Court said in the *Silberman* case, to what is little more than a "chose in action", or as Judge Learned Hand expressed it at greater length in the *Lehman* case (165 F. (2d) 385):

> "The practical effect of these interpolations into the common law was to impound firm assets and deprive the individual partners of any control over them except in so far as they were dealing with them on behalf of the firm as a unit. The individual partner's beneficial interests as a legal joint owner were trimmed down so that he had nothing left save that the firm assets should be devoted to the firm business, that he should share in any profits they produced and in the surplus upon winding up, whether voluntary or by legal process."

While a partner is a co-owner of the partnership assets, holding as a "tenant-in-partnership", the rights of the partners in such assets are now so far cut down and circumscribed that they have no resemblance at all to individual ownership. A sale of assets dedicated to the partnership enterprise and made for partnership purposes surely is not that kind of sale which may be characterized as a sale by "an individual", particularly when every consideration bearing upon the question shows that it was not the intention of Congress to do so, as the Tax Court unanimously found.

POINT IV

The Court below erred in reversing the unanimous decision of the Tax Court when such decision had warrant in the record and a reasonable basis in law.

In *Dobson* v. *Commissioner* (*supra*, p. 6), this Court held that "the judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body." This principle, based as it is upon the weight to be given to the expert opinion of the Tax Court, could hardly be more plainly demonstrated than in the present case. Here all 16 judges of the Tax

Court concurred in the conclusion that the term "individual" did not include a partnership. Surely there was a rational basis for this conclusion, and the Court below was plainly in error in substituting its views for the expert opinion of the Tax Court. In *Commissioner* v. *Estate of Bedford*, 325 U. S. 283, 292 (1945), this Court said:

> "As is true of other teasing questions of construction raised by technical provisions of Revenue Acts the matter is not wholly free from doubt. But these doubts would have to be stronger than they are to displace the informed views of the Tax Court."

In *Labor Board* v. *Hearst Publications*, 322 U. S. 111 (1944), this Court, in construing the word "employee" as it appeared in the National Labor Relations Act, said (p. 131):

> "• • • where the question is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially, the reviewing court's function is limited. • • • the Board's determination that specified persons are 'employees' under this Act is to be accepted if it has 'warrant in the record' and a reasonable basis in law."

CONCLUSION

The Court of Appeals' decision reversing the Tax Court is in conflict with applicable decisions of this Court, attributes unwarranted discriminatory intent to Section 24(b) of the Internal Revenue Code, and raises questions of continuing public importance in the administration of Federal tax law. Writs of certiorari to review it should therefore be granted.

Respectfully submitted,

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New York, N. Y., October 28, 1948.

APPENDIX

Section 24(b) of the Internal Revenue Code as applicable in 1940 provides as follows:

"(1) LOSSES DISALLOWED.—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2)(D);

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(D) Between a grantor and a fiduciary of any trust;

(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(F) Between a fiduciary of a trust and a beneficiary of such trust.

(2) STOCK OWNERSHIP, FAMILY, AND PARTNERSHIP RULE.—For the purposes of determining, in applying paragraph (1), the ownership of stock—

(A) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(B) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(C) An individual owning (otherwise than by the application of subparagraph (B)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(E) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—Stock constructively owned by a person by reason of the application of subparagraph (A) shall, for the purpose of applying subparagraph (A), (B), or (C), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of subparagraph (B) or (C) shall not be treated as owned by him for the purpose of again applying either of such subparagraphs in order to make another the constructive owner of such stock."

Section 182 of the Internal Revenue Code as applicable in 1940 provides as follows:

"In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b)."

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In the Supreme Court of the United States

OCTOBER TERM, 1948

Nos. 373–385

GEORGE WHITNEY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

AND 12 CONSOLIDATED CASES

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 4a–31a) are reported at 8 T. C. 1019. The opinion of the Court of Appeals (R. 257a–274a) is reported at 169 F. 2d 562.

JURISDICTION

The judgments of the Court of Appeals were entered on August 11, 1948. (R. 275a–300a.) A petition for writs of certiorari was filed on Octo-

ber 29, 1948. The jurisdiction of this Court is conferred by 28 U. S. C. 1254.

QUESTION PRESENTED

The taxpayers were members of a partnership which, preparatory to dissolution, sold a substantial amount of its assets to a corporation (the majority of whose capital stock was owned by the taxpayers) which was to continue the business.

Was the Court of Appeals correct in holding that Section 24 (b) (1) (B) of the Internal Revenue Code prohibits the taxpayers from taking a deduction for losses resulting from the sale?

STATUTE INVOLVED

The applicable provisions of the statute involved are set forth in the Appendix, *infra*, pp. 14–17.

STATEMENT

These consolidated proceedings involve asserted deficiencies in individual income taxes for the calendar year 1940. The thirteen taxpayers[1] were partners in the firm of J. P. Morgan & Company. After many years of carrying on the banking business through a partnership, the partners decided to utilize the corporate form. Accord-

[1] Although some of the taxpayers filed joint returns and some are estates of deceased partners, for convenience the partners will be referred to as though they were the only taxpayers. The names of all the taxpayers are set forth in the captions to the judgments entered by the Court of Appeals. (R. 275a–300a.)

ingly, a corporation was duly organized and its stock was issued to the taxpayers and others for cash. The taxpayers acquired more than 72 percent of the stock and their relatives acquired more than 5 percent. (R. 6a, 8a–9a.)

On March 30, 1940, after the corporation had been organized and its stock subscribed for, most of the assets used by the partnership in the banking business (having a value in excess of $597,000,000) were transferred to the corporation. The corporation agreed to assume certain outstanding liabilities of the partnership and the difference in value, amounting to more than $12,000,000, was paid by the corporation to the partnership. On the same day, the partnership paid over substantially the same amount in cash to the corporation to the credit of the individual personal accounts of the thirteen partners. (R. 6a–8a.) The assets were transferred from the partnership to the corporation pursuant to a bill of sale which was signed in the partnership name and by the thirteen partners, individually. (R. 8a, Pet. Ex. 25, R. 224a–237a.)

The sale of assets to the corporation resulted in certain gains and certain losses. Each of the individual partners, in his income tax return for 1940, claimed his distributive share of the losses as well as of the gains. The Commissioner asserted tax deficiencies which resulted, in part, from his determination that the individual partners could not claim any part of the losses as

The broad legislative purpose of denying deductions where genuine economic losses might be absent—a purpose attested to by the *McWilliams* decision and by the history of the section [3]—did not fall wide of the legislative mark in the area covered by this case. The contrary contention of the taxpayers, namely, that Congress purposefully excluded dealings between a partnership and a corporation controlled by the partners (Pet. 9; Br. 13–16) is not only unsupported by any particular matters of legislative history, but is contrary to the whole tenor of the legislative intent which bears on the specific subject matter.

Congress was undeniably disturbed by instances where, for the purpose of establishing tax losses, one business partner would route individual transactions through his partner's closed corporation or personal holding company. See Hearings before the Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess., Part 2, pp. 216–218. Because of this, the Joint Committee stated (H. Doc. No. 337, 75th Cong., 1st Sess., p. 14):

> Because of the close relationship existing between partners, your committee

[3] House Committee Print, Prevention of Tax Avoidance, Preliminary Report of a Subcommittee of the Committee on Ways and Means, 73d Cong., 2d Sess., pp. 14–15; H. Rep. No. 704, 73d Cong., 2d Sess., p. 23 (1939–1 Cum. Bull. (Part 2) 554, 571); S. Rep. No. 558, 73d Cong., 2d Sess., p. 27 (1939–1 Cum. Bull. (Part 2) 586, 607); Report of Joint Committee of Congress on Tax Evasion and Avoidance, H. Doc. No. 337, 75th Cong., 1st Sess., pp. 14–15; H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 26–29 (1939–1 Cum. Bull. (Part 2) 704, 722–724).

> recommends that losses should be disallowed between an individual and his partner's corporation if such individual owns stock in such corporation.

This recommendation was adopted and incorporated in the 1937 amendments to the basic section.[3]

Having acted to deny losses on transactions where one partner, individually, sells property to a corporation in which he holds a small amount of stock but in which his partner owns the controlling stock interest, it is inconceivable that Congress should have specifically intended, as the taxpayers assert, to permit such losses to be deducted if the property transferred to the corporation consists of partnership property. Actually, situations like the present case are more compelling for denying loss deductions than the one which Congress corrected in 1937. For, when partnership property is transferred to a corporation controlled by the partners, each partner suffers even less (if any) genuine economic loss than is true where one partner sells his individual property to a corporation dominated by his partner. In the former, the investment of the individual continues in another form; in the latter, it may have been largely terminated. There is no basis for concluding that Congress expressly acted to deny loss deductions in one

[3] Section 301, Revenue Act of 1937, c. 815, 50 Stat. 813. See H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 26–29 (1939–1 Cum. Bull. (Part 2) 704, 722–724).

situation involving partners, but intended to permit such deductions to be taken by the partners in circumstances where the reasons calling for denial of the deductions are more clearly present. It is true that Section 24 (b) (1) (B) does not cover all instances where artificial losses might exist (Pet. Br. 14); it seems plain, however, that the relationship between partners, partnerships, and corporations controlled by them was not one of the omitted areas.[4]

We may briefly refer to other matters which persuasively confirm the construction of the statute upheld by the Court of Appeals. Section 24 (b) (1) (B) would prevent deductions for losses when business property of a syndicate, group, pool, or joint venture is sold to a corporation controlled by the members who constitute the organization.[5] Clearly this section cannot draw distinctions between such sales and sales of partnership property to a corporation controlled by the partners. This is so because Congress, for all income tax purposes, has defined the term

[4] Lest an erroneous impression be created by the taxpayers' assertions (Pet. 8–9; Br. 12–13), we wish to make plain our position that there would not be any deductible losses on a sale of property from one partnership to another firm composed of identical partners. There would not even be a realization of loss in such a situation which would be tantamount to a transfer from a group of persons back to themselves.

[5] The taxpayers agree that this is the proper interpretation of Section 24 (b) (1) (B). See their reply brief in the Court of Appeals, pp. 11–12.

"partnership" as including these other kinds of business organizations where the members are joint owners of the business assets and has defined the term "partner" as including a member of any of these organizations. Section 3797 (a) (2), Internal Revenue Code (Appendix, *infra*). Accordingly, it seems plain, as the court below noted (R. 265a–266a), that Congress would have had no rational purpose in distinguishing between the members of these various business organizations for the purpose of permitting to some, but denying to others, the very same kind of loss deductions. Further, the fact that Section 24 (b) (1) (B) covers sales or exchanges made "directly or indirectly" is persuasive that the correct interpretation of the congressional intent is not to be achieved by the narrow approach advocated by the taxpayers which assigns niggardly values to statutory language intended to have broader implications.

Finally, it cannot be successfully contended that Congress failed in achieving its purpose because of an asserted neglect to employ the proper language in the statute. Section 24 (b) (1) (B), in disallowing loss deductions arising out of sales made by an "individual", used language sufficiently apt to describe sales of partnership property. In taxing partnership income to the partners, rather than to the partnership, Congress elsewhere in the taxing statute (Secs. 181–183, Appendix, *infra*) considers the partners as the

owners of the partnership property. See: Rabkin and Johnson, *Federal Taxation of Partnerships,* 55 Harv. L. Rev. 909, 915 (1942). The mechanics of the statutory scheme are actually apparent from the fact that here it is the individual partners who are claiming the loss deductions in their tax returns. It is not surprising, therefore, that in Section 24 (b) (1) (B), Congress should have also viewed a sale by the partnership as being no more than a sale by the individual partners, the same as would be true of other joint owners. This is particularly so because of the definitions contained in Section 3797 (a) (2) which, as has already been mentioned, places in the category of partners all kinds of joint owners of business property. And, while local law may have played no decisive part in the concepts employed in the taxing statute, it is significant that local law would regard the sale here as having been made by the partners. That is, it is undisputed that the express assent of all the individual partners is required to effectuate a sale of partnership assets which would make it impossible for the firm to continue in business. That assent was manifested in this case by the fact that each of taxpayers individually signed the bill of sale. Consequently, it was not unsuitable for Congress to describe the sale here as made "directly or indirectly" by the individual partners.

2. The issue decided by this case does not involve "the true status of a partnership for tax

purposes." (Pet. 5.) The decision below does not constitute a ruling, as a matter of general law, on the nature of partnerships or on the ownership of partnership assets. (Pet. 7–8; Br. 17–18.) Nor does it purport to draw universal conclusions concerning partnership matters which would necessarily possess uniform applicability throughout the taxing statute. (Pet. 5–6.) The present case decides no more than the meaning of Section 24 (b) (1) (B) as it relates to circumstances where partners, in liquidating their partnership business, caused the partnership assets to be transferred to a corporation controlled by them. As the court below pointed out, the questions which the taxpayers raise (R. 262a) "are fascinating in their possibilities for semantic dispute." But neither they nor any other aspects of a (R. 262a) "jurisprudential debate" are decisive of the question of statutory construction, which is the only issue here. Conversely, a decision relating to the correct interpretation of Section 24 (b) (1) (B) does not provide definitive answers to the problems raised by the taxpayers, important as they may be. For example, whether Section 24 (b) (1) (B) disallows a deduction for the losses in this case does not at all determine questions like that presented in *Commissioner* v. *Lehman,* 165 F. 2d 383 (C. C. A. 2d), certiorari denied, 334 U. S. 819, which involved an important question concerning one aspect of the taxable status of a partner's interest in the partnership business.

The taxpayers' contentions that the reversal of the Tax Court (Pet. 6) "plainly violated the rule of" *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, and that (Br. 19) "there was a rational basis" for the Tax Court's conclusion, seem calculated to give the case an exaggerated importance. The very same section of the statute was presented for construction in *McWilliams* v. *Commissioner, supra,* and the Court there (p. 703) expressly rejected the contention that *Dobson* controlled. Accordingly, the Tax Court's erroneous construction of the statute here was no more precluded from judicial review than it was in the *McWilliams* case. Since the Court of Appeals was empowered to reverse under the statutory provisions in effect when the case was decided, it is plain that any problems that might be presented by the amendment to Section 1141 (a) of the Internal Revenue Code,[6] which first became effective September 1, 1948, are purely academic to this case. The amendment to Section 1141 (a), moreover, was designed to broaden, not restrict the authority of the reviewing courts.

3. There is no conflict in decisions. *Case* v. *Beauregard,* 99 U. S. 119, and *Blodgett* v. *Silberman,* 277 U. S. 1, the only decisions relied on by the taxpayers (Pet. 7–8; Br. 17–18), plainly have nothing to do with the case at hand. The

[6] Section 1141 (a) was amended by Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess.

former, which dealt with the rights of firm creditors to property which had been conveyed by the partners, and the latter, dealing with the constitutional authority of a state to impose a transfer tax, do not possess any significance in determining congressional intent within the framework of the statutory provisions which were construed by the lower court here. Nor is there any warrant for the assertion that the court below (Br. 17) "repudiated even its own prior decision in *Commissioner* v. *Lehman.*" While we think that the *Lehman* decision is wrong, the two cases, dealing as they do with totally different problems, are not at all inconsistent in result, and the court below did not purport even to question the decision in the *Lehman* case. (R. 267a–269a.)

CONCLUSION

The petition for writs of certiorari should be denied.

Respectfully submitted,

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NOVEMBER, 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * *

(b) *Losses from Sales or Exchanges of Property.*—

(1) *Losses Disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2) (D);

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each

of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(D) Between a grantor and a fiduciary of any trust;

(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(F) Between a fiduciary of a trust and a beneficiary of such trust.

* * * * *

(26 U. S. C. 1946 ed., Sec. 24.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) *Segregation of Items.*—

(1) *Capital Gains and Losses.*—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) *Ordinary Net Income or Loss.*—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable Contributions.*—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3797.)

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